



Testimony of Stephen P. B. Kranz

Before the

Subcommittee on Commercial and Administrative Law

Of the

Committee on Judiciary
United States House of Representatives

Hearing on

State and Local Telecommunications Taxation

*Framing the Debate Over the Need for Federal Legislation
Addressing State and Local Taxation of Telecommunications Services*

June 13, 2006

I am Stephen Kranz, Tax Counsel for the Council On State Taxation. The Council On State Taxation ("COST"), is a non-profit trade association formed in 1969 to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 of the largest corporations in the United States, including companies from every industry segment. COST's membership includes the traditional telecommunications service providers and many companies whose products are now bleeding into the telecommunications space. As such, COST's membership has been and continues to be concerned about the administrative and financial tax burden imposed on these services.

I am honored by the Chairman's invitation to testify today. I welcome the opportunity to share with the Subcommittee the analysis that COST has developed regarding the burden imposed by our current structure of state and local taxation of telecommunications services. While one might not need a fifty state study to understand the complexity and burden that exists – a glance at any phone bill will do the job – COST has issued four fifty-state studies of telecommunications taxation to more accurately evaluate the scope of the problem. The most recent study, the 2004 version, is the subject of my testimony today.

I. 2004 STATE STUDY AND REPORT ON TELECOMMUNICATIONS TAXATION

The 2004 50-State Study and Report on Telecommunications Taxation ("2004 State Study"), was prepared by the Telecommunications Tax Task Force¹ of the Council On State Taxation ("COST"). This study documents the current state of state and local taxation of telecommunications and analyzes changes that have occurred in the taxation of telecommunications since COST issued its last study in 2001.

Background

COST developed its original study in 1999 ("1999 State Study") in an effort to document the complex taxation of telecommunications providers and services under state and local transaction and property taxes, including certain special fees and taxes. The 1999 State Study highlighted the cumbersome and burdensome nature of the situation by comparing the relative tax and administrative burdens imposed on both general business and telecommunications providers and services under state and local transactional and property taxes.

¹ Individuals at the following COST member companies participated in the effort required to prepare the 2004 State Study: ALLTEL Corporation, AT&T Corporation, BellSouth Corporation, Cingular Wireless LLC, Level 3 Communications, Nextel Communications, Qwest Communications, SBC Communications, Sprint Corporation, Telephone and Data Systems, Inc., T-Mobile USA, Verizon Communications, Verizon Wireless.

Members of the COST Telecommunications Task Force compiled the 1999 State Study to provide the Advisory Commission on Electronic Commerce ("ACEC") with information documenting the onerous federal, state, and local level of taxation imposed on telecommunications. The 1999 State Study was presented to the ACEC at its second meeting in New York City on September 14, 1999.

The original study, and each version since, has generated substantial interest from the public and private sectors. The data documented in the study has been referenced in numerous articles and studies,² and is the focal point for much of the policy debate over telecommunications tax reform.

The Federal Discussion

The majority report of the ACEC, presented by Governor Gilmore to Congress in April of 2000, called for the elimination of multiple and discriminatory taxation of telecommunications services and property by 2004. It is now 2006 and the excessive tax burden on telecommunications continues virtually unabated.

The State Discussion

As a result of the ACEC recommendations in 2000, and in particular the recognition that federal legislation would be in order if discrimination were not eliminated by 2004, State and Local Government representatives and organizations offered to work with representatives of the industry toward a solution. They formed a group called the Telecommunications Tax Reform Initiative (TTRI), whose efforts were folded into the Streamlined Sales Tax Project (SSTP). Before and since the ACEC recommendations, the telecom industry has engaged in discussions and dialogue with state and local government representatives in various contexts. As recently as December of 2004, the industry renewed discussions with a broad group of state and local government organizations, including the National Governor's Association, the National Conference of State Legislatures, The Council of State Governments, the National Association of Counties, the National League of Cities, and the United States Conference of Mayors. As documented in COST's most recent 2004 Study, however, and although a few states have taken steps to reform parts of their telecommunications tax laws, there really has been no meaningful progress toward eliminating the multiple and discriminatory state and local taxes imposed on telecommunications.

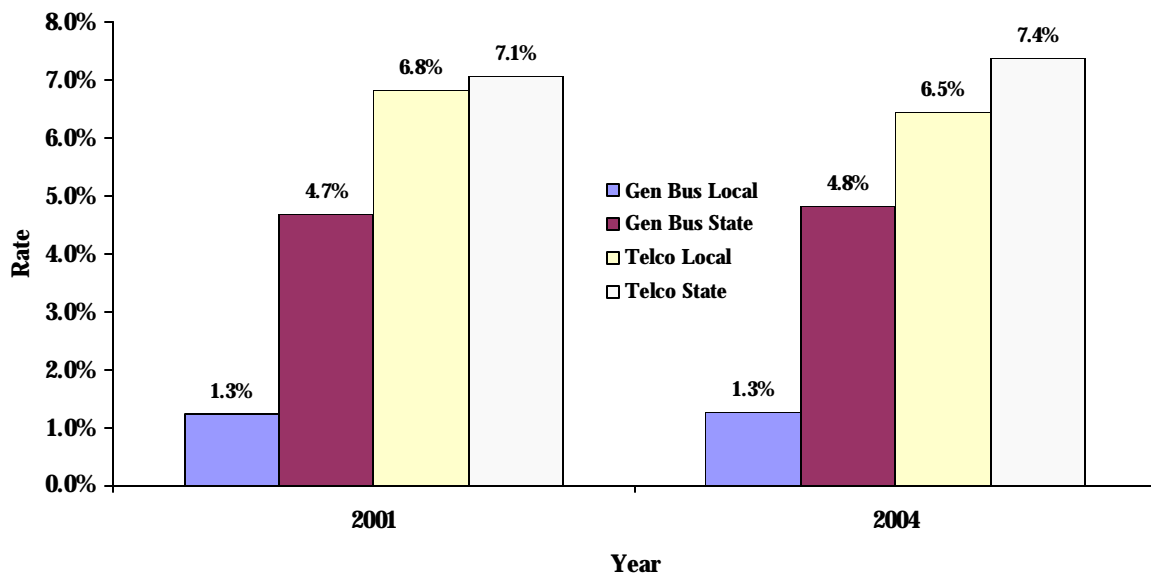
² See "Fixing the Phone-Tax Mess before it Gets Worse," Scott Palladino and Stacy Mazer, *Telecommunications Tax Policies: Implications for the Digital Age*, National Governors' Association, Washington, D.C., February 2000; *Business Week*, May 8, 2000; Joseph Cordes, Charlene Kalenkoski, and Harry Watson, *The Tangled Web of Taxing Talk: Telecommunications Taxes in the New Millenium*, The Progress & Freedom Foundation, September 2000; Jerry Hausman, "Efficiency Effects on the U.S. Economy from Wireless Taxation," *National Tax Journal*, Vol. 53 No.3 Part 2, p. 734 (September 2000); Scott Mackey, *Telecommunications and the Tangle of Taxes*, National Conference of State Legislatures, Denver, Colorado; Stephen Pociask, Telenomic Research "Taxing High-Speed Services: A Quantification of the Effects on the DSL Industry and Universal Service," New Millennium Research Council (April 26, 2004).

The 2004 State Study Findings

The 2004 State Study shows that the average effective rate of state and local transaction taxes for telecommunications services is **14.17%, compared to only 6.12%** for general businesses nationwide. Transaction taxes for telecommunications services include any state and local taxes applied to the cost of the service or the provision of the line to the consumer. Transaction taxes for general businesses are based on the traditional sales tax imposed on sales of tangible personal property and comparable transaction taxes. When accounting for federal transaction taxes the average effective rate for telecommunications services is 18.17% compared to 6.12% for general businesses nationwide.³

The following chart compares the change in the average effective rate from the 2001 study to the 2004 study. The comparison shows a slight decrease in the local rate from 6.8% to 6.5% and a slight increase in the state rate from 7.1% to 7.4%. Two factors account for the majority of the change. First, the 2004 study uses a higher average cost for service. As a result, the conversion of flat charges to an average effective rate produces a lower average effective tax rate even though the actual tax per line did not change. Second, the change reflects the simplification reforms enacted in some states shifting the tax burden from local level taxes to state level taxes.

Comparison of Tax Rates, 2001 - 2004: Local & State Rates for Gen Bus vs. Telco

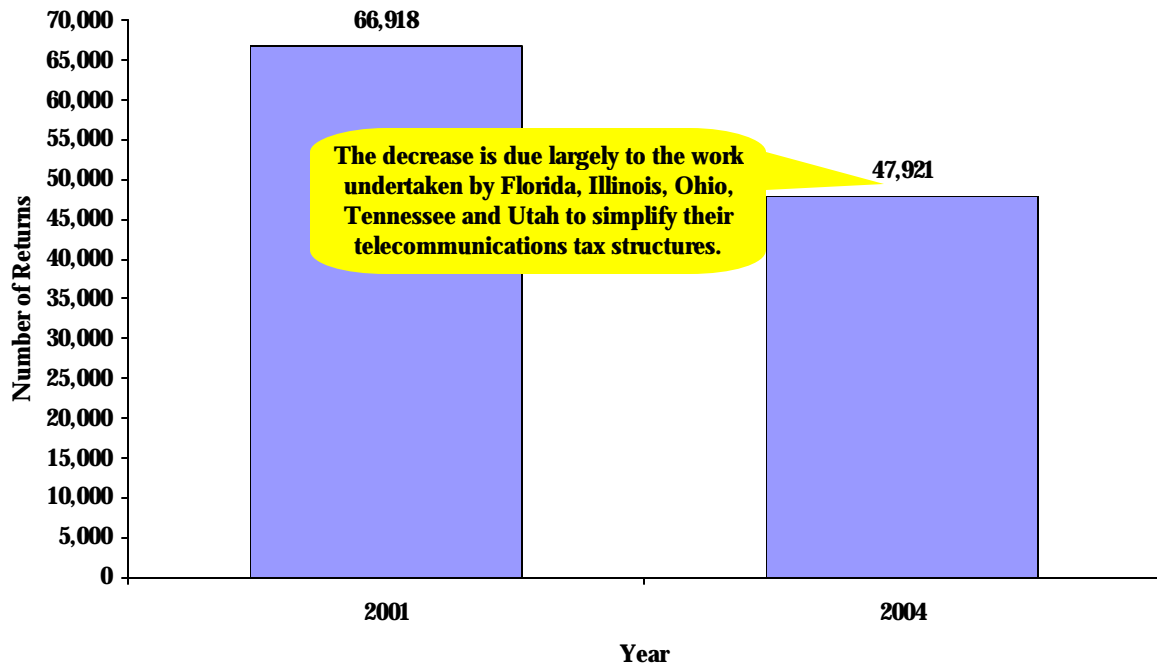


The total number of taxes imposed on telecommunications services is almost three times greater than for general businesses (123 versus 344). Compared to general businesses, telecommunications providers have 1,103 more transaction tax bases and 6,683 more

³ The federal rate of 4% reflects the federal excise tax on telecommunications plus an additional 1% to reflect the impact of the universal fund surcharges.

taxing jurisdictions with which to contend. Telecommunication providers must file 47,921 returns compared to 7,501 returns for general businesses. These inequities stem from outmoded statutes that originated during the era when telecommunications companies were closely regulated monopolies. These outmoded and discriminatory tax schemes no longer work in today's competitive and highly dynamic environment.

Total Number of Returns Required Nationwide



COST Telecommunications Task Force Conclusions

Deregulation of the telecommunications industry, convergence of technologies and providers and increased competition continue to have an impact on the competitive marketplace. The state and local tax laws continue to impose high levels of industry-specific taxation on telecommunications services. While some states have begun the process of reforming the state and local tax structure, much more is needed to reduce the high level of telecommunications taxation and administrative burden imposed at most levels of government. As business and residential consumers become increasingly reliant on communications services provided over the nation's telecommunications networks, the burdens and complexities imposed by the existing telecommunications tax system will continue to have a substantial impact on the cost of such services to consumers. The burdens and complexities of the existing telecommunications tax system are evidenced by the data contained in the 2004 State Study.

Currently, the language in many tax statutes results in the imposition of different taxes on similar telecommunications services depending on the historic classification of the business providing the service. New technologies are having an impact on the types of services being provided to customers, the method of delivery and the means of

accounting for such services.

The tax system has not kept pace with changes in telecommunications technology, generally rendering the current system inequitable and unworkable. The telecommunications tax system should be overhauled to eliminate the discriminatory administrative and tax burden facing telecommunications providers and services.

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My purpose here is only to describe the issue for the benefit of the Subcommittee and not to address the difficult political issues that are raised by attempting to reconcile the demands of a streamlined telecommunications tax structure and the concerns of state and local political subdivisions.

Once again, I thank the Chairman for inviting me to testify before this Subcommittee, and I will be happy to respond to any questions or to provide any other assistance that the Chairman or other Members of the Subcommittee may find helpful.